Legal Assistance Foundation of Metropolitan Chicago

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April 6, 2004

Re: Proposed Revisions to CRA Rule
OCC Docket No. 04-06
FRB Docket No. R-1181
FDIC RIN 3064-AC50
OTS Docket No. 2004-04

Docket No. 04-06
Communications Division
Public Information Room, Mailstop 1-5
Office of the Comptroller of the Currency
250 E St. SW,
Washington 20219
(f) (202) 874-4448

Docket No. R-1181
Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC 20551
(f) (202) 452-3819

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th St NW
Washington DC 20429
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Regulation Comments, Attention: No. 2004-04
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington DC 20552
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Officials of the Federal Bank and Thrift Agencies:

I am writing on behalf of the Legal Assistance Foundation of Metropolitan Chicago (LAF) on proposed changes to the regulations enforcing the Community Reinvestment Act (CRA). For over 25 years, LAF has provided free legal services to low-income Chicagoans. I serve as the Supervisory Attorney of the Home Ownership Preservation Project (HOPP), a special project of LAF which was formed in the mid-1990's in response to the crisis of escalating foreclosures in the Chicagoland area. Our project has advised and represented thousands of homeowners faced with the loss of their homes due to the aggressive marketing of high-cost mortgage loans, a problem as prevalent here in Chicago as anywhere in the country. Many of our clients are seniors who are not only facing the loss of their homes, but of their only significant asset.

While we have been able to save the homes of many of our clients, we are only able to represent a small fraction of the thousands of homeowners sued in foreclosure court every year. That is why we are also active participants in the Chicago CRA Coalition and the Illinois Coalition Against Predatory Home Loans. We know that preventing bad lending practices is far more effective that trying to fix them. Amending the CRA regulations provides one such opportunity, and it makes sense to use the CRA in this way: predatory lending, also known as "reverse redlining," exists largely because unscrupulous lenders have moved in to fill the vacuum left after traditional lenders have disinvested from urban minority communities.

Unfortunately, the proposed changes to the regulation move in the wrong direction: they offer less coverage, and they miss an important opportunity to include meaningful review of predatory lending activities.

1. <u>Small Bank Limits</u>

The proposed CRA regulation would change the definition of "small bank" from any institution with less that $250 million in assets and not part of a holding company with over $1 billion in assets to include all institutions with less than $500 million in assets regardless of holding company size. This change would dramatically increase the number of banks considered "small" that, for CRA purposes, are not examined for their levels of community investment and services under the streamlined small bank CRA examination. In Illinois, it would reduce the number of institutions covered by the comprehensive CRA exam by about 63%, from 198 banks to 74. This would significantly reduce available data on small business lending despite the fact that it has been shown that small banks have a larger share of their lending dedicated to small businesses than larger banks.

We are also concerned that by removing the holding company threshold from the definition of small bank, regulators will not only reduce the number of institutions covered by comprehensive CRA, but also have created a potential loophole for large holding companies to exploit when trying to evade CRA compliance. This change raises the possibility that large holding companies will re-form their banking subsidiaries as a series of local "small banks" to avoid comprehensive CRA examinations. In the Chicago area, such an institution already exists. Harris Trust and Savings currently has 26 separately chartered institutions in the Chicago area totaling over $30 billion in assets. Of these institutions, 19 would be considered "small" under the new CRA regulation despite being part of Bancmont Financial Corp, a holding company with over $39 billion in assets in the United States. Of those Harris institutions not covered, at least three serve communities with significant low-income or minority populations. Although we do not feel that Harris has structured its holding company to evade CRA compliance, we feel that holding companies could use this structure as a model to avoid significant compliance with CRA.

2. Affiliate Lending and Assessment Areas

Regulators missed a significant opportunity to modernize CRA by not requiring affiliate lending to be considered in CRA exams. As bank holding companies increasingly use non-bank lenders to originate mortgages, it is critical that all lending affiliates be required to report lending in an institution's CRA exam. As currently structured, the CRA regulation allows banks to choose which affiliate loans in a given assessment area they want to apply toward the lending test. This allows institutions to select the best lending affiliates for each assessment area and to exclude affiliates in assessment areas where those affiliates might not be adequately serving the community. As holding companies increasingly acquire non-bank lenders, often subprime lenders, it is critical that this loophole be closed and all lending affiliates be considered in CRA exams.

3. Predatory Lending Standard

By mirroring the OCC and setting a weak anti-predatory lending standard, regulators are missing a significant opportunity to send a strong statement about predatory lending. The proposed standard allows that loans originated based on the foreclosure value of the collateral rather than a borrower's ability to repay can negatively affect a bank's CRA exam. This is a weak standard which fails to target numerous identifiable predatory loan terms and practices. For instance, the agencies could use the list of predatory lending in the recent GAO Report on Predatory Lending: excessive fees, excessive interest, single premium credit insurance, loan flipping, balloon payments and prepayment penalties. As the GAO Report points out, some of these lending practices can sometimes be useful for borrowers, but often they are not, and so their prevalence in a loan portfolio should trigger heightened scrutiny of the CRA record of the lender. Below are our comments focusing on three of these areas (excessive fees, loan flipping, and prepayment penalties), as well as comments on two additional we feel are vitally important: mandatory arbitration clauses and certain (dangerously) "loose" underwriting procedures.

High fees

Most legitimate loans have relatively low financed fees of 3% or less. A pattern of loans made with high financed fees should create concern and should be cause for a reduction of the CRA rating. Most lenders now are careful in the refinance context to finance less than 8% of the loan amount, in order to avoid HOEPA coverage. Indeed, many states (including) have recently passed laws modeled on HOEPA but which define as high-cost or high-risk mortgage loans including financed fees in excess of 5% (still a high threshold). North Carolina led the way in setting the 5% threshold, and after five years the volume of mortgage lending in that state has not been adversely affected.[1] Therefore, any institution that routinely finances more than 5% of the total loan amount in fees should receive additional scrutiny as to its potentially predatory practices.

[1] The study entitled, "North Carolina's Subprime Home Loan Market After Predatory Lending Reform," is available on-line at (http://www.responsiblelending.org/pdfs/HMDA_Study_on_NC_Market.pdf).

Loan flipping

One of the most common methods of stripping equity from low-income communities is the repeated refinancing of homes, with ever increasing principal, made up of new fees and costs for the refinancing. Many states (including Illinois) attempt to address abusive lending practices by limiting the repeated refinancing of some or all home loans.[2] Collecting a prepayment penalty on a loan refinanced by the same lender or an affiliate is already prohibited for HOEPA loans.[3]

For most borrowers, there is no reason to refinance a loan that is less than 12 months old. Certainly there is no reason for most borrowers to refinance a loan less than 12 months old without a significant drop in the interest rate. In order for a refinancing to benefit a borrower who is not in urgent financial distress, the borrowers' monthly loan payments should drop and the total amount the borrower is paying over the life of the loan should also decline, adjusted perhaps for real cash to the borrower (not cash paid for unsecured debt or the costs of refinancing).

Any individual refinancing may make sense, but in the aggregate, most lenders and most borrowers should not be refinancing loans within 12 months of the initial transaction. A pattern and practice of refinancing loans less than 12 months old should subject the lending institution to heightened scrutiny and adverse CRA treatment, if other circumstances warrant.

Prepayment penalties

Prepayment penalties in the subprime market tie borrowers into expensive loans and seldom function to reduce the actual cost of credit. There is no good reason (other than to trap borrowers) for imposing prepayment penalties which last longer than three years, and this is the length of time used as a standard in most new local and state laws (as in Illinois). A pattern and practice of imposing prepayment penalties of more than three years in duration or of imposing prepayment penalties without a corresponding drop in the interest rate offered should subject the lending institution to heightened scrutiny and possible adverse CRA treatment.

Mandatory arbitration

There are two additional practices we believe should also trigger heightened scrutiny of a lender's portfolio. The first is a lender's insistence on binding arbitration. The presence of binding arbitration often guarantees that abusive practices will not be challenged, since it is often not economically feasible for an individual borrower to challenge an abusive practice, and arbitration agreements typically prevent class-wide arbitration. Perhaps even more troubling from a policy viewpoint, mandatory arbitration prevents full disclosure as to the extent of a problem at an institution, since arbitration decisions are not public documents.

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[2] E.g., 815 ILCS 137/45("No lender shall refinance any high risk home loan where such refinancing charges additional points and fees within a 12-month period after the original loan agreement was signed, unless the refinancing results in a tangible net benefit to the borrower."); 815 ILCS 120/3(e) (complete ban on "loan flipping," defined as "refinancing a loan secured by the person's principal residence for the primary purpose of receiving fees related to the refinancing when (i) the refinancing of the loan results in no tangible benefit to the person and (ii) at the time the loan is made, the financial institution does not reasonably believe that the refinancing of the loan will result in a tangible benefit to the person.")

[3] 12 C.F.R. §226.32(d)(6)(ii).

“Lite doc” or “No doc” loan underwriting

Finally, there are certain loose underwriting standards which go to the heart of predatory lending, that is, to the practice of improvident lending. Brokers arrange loans which borrowers cannot really afford, based on loan applications which do not accurately reflect true income. Brokers (and sometimes loan officers) “cook the numbers” to “make the loan work,” either insisting to the borrowers that “this is how it’s done,” or without the borrower even knowing what is happening. The end result is the same: the borrower is stuck in a loan that is doomed to lead them into foreclosure.

This practice is facilitated more than anything else by loose underwriting policies (or “programs”) known as “lite doc,” “no doc,” or “stated income”: in each case, the lender is willing to make the loan based upon little or no reliable verification of income (as would be provided, for example, by pay stubs or W-2 statements). This practice is widespread in the (predatory) lending industry, and by now it should surprise absolutely no one familiar with the industry that these loose underwriting programs encourage brokers to fraudulently report income: there are simply no strong safeguards in place to counter the heavy incentives for doing so.

Indeed, these loose underwriting programs lead back to the one area the proposed regulation does target: asset-based lending, or lending based upon the value of the collateral, rather than on the affordability of the loan. In a sense, these underwriting programs represent the smoking gun of improvident, or asset-based, lending. For that reason, the routine presence of these underwriting programs in loans issued or bought by a lending institution should subject them to heightened CRA scrutiny.

Thank you for the opportunity to offer the above comments.

Sincerely,

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